

MAINE STATE LEGISLATURE

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HAND DELIVERED

February 27, 2019

Senator Shenna Bellows, Senate Chair
Representative Mike Sylvester, House Chair
Members, Joint Standing Committee on Labor and Housing
100 State House Station
Augusta, ME 04333-0100

Dear Senator Bellows, Representative Sylvester and Members of the Joint Standing Committee on Labor and Housing:

Please accept the Maine Public Employees Retirement System's ("MainePERS" or "System") annual report to the Joint Standing Committee on Labor and Housing. This report is prepared in response to 5 M.R.S. § 17103, sub-§11 requiring the MainePERS Board of Trustees to submit a written report about the Maine Public Employees Retirement System to the appropriate legislative committee each year by March 1. The System's Comprehensive Annual Financial Report (CAFR), copies of which are being provided to the Committee and which is available at www.mainebers.org, provides detailed information that supplements this report.

We are pleased to provide this information. Except where indicated, this report is based on operations through June 30, 2018.

INVESTMENTS

The market value of the System's defined benefit plans trust fund at June 30, 2018 was \$14.3 billion. The net position of the trust fund increased as net investment earnings and contributions for the fiscal year were greater than payments to retirees. The market value investment return for fiscal year 2018 was 10.3%. The preliminary fund return through the first seven months of FY 2019 ending January 31st was 2.3%.

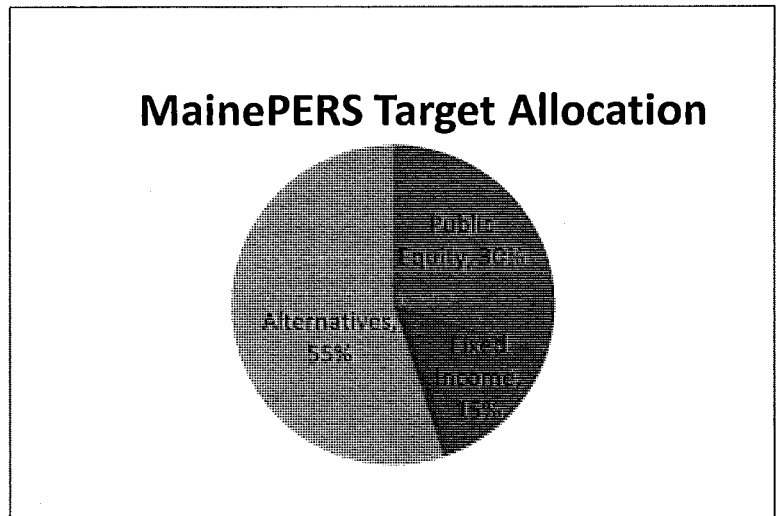
The System's investment strategy remained consistent throughout FY 2018. This resulted in positive returns to the fund due partially to strong markets in private and public domestic and international equities, and a slightly positive return from fixed income markets.

Fiscal Year Ending	Fund Value	Investment Return*
June 30, 2016	\$12.3B	0.6%
June 30, 2017	\$13.4B	12.5%
June 30, 2018	\$14.3B	10.3%

*Refers to performance of the investments, not the change in Fund Value

Annualized market value returns, net of management fees, for the 3-year, 5-year, 10-year, and 30-year periods ending on June 30, 2018 were 7.7%, 8.2%, 6.3%, and 8.2%, respectively. The 10-year and 30-year returns include the 2008-2009 market downturn.

In 2017, the System changed its target asset allocation to 30% publicly traded stocks, 15% fixed income investments, and 55% alternative investments. This change is forward looking and designed to balance risk and returns in current and near-term future markets. The alternative investments allocation includes 10% in infrastructure, 15% in private equity, 10% in real estate, 5% in alternative credit, and 5% in natural resources, which may include agriculture, timber, and commodities. In addition, the Board of Trustees has approved a 10% allocation to risk diversifiers that seek sound investment strategies that do not fall into one of the other asset categories. The current allocation to alternatives is approximately 46.7% of the System's portfolio at June 30, 2018.



MainePERS maintains a substantial portion of the fund in return-seeking assets such as publicly traded equities and private equity. This is because most of the System's benefit payments are not due for several decades into the future and current fund liquidity is strong enough to withstand a full-range of market scenario testing. For the past ten years, the System has invested between 60% and 70% of its assets in equities. Over sufficiently long periods, equities have been shown to outperform bonds. The System expects this relationship to hold in the future.

All of the assets of the System's retirement plans and other funds are in portfolios managed by professional investment management firms. These managers act as fiduciaries and invest the assets assigned to them in accordance with the System's investment policies and the individual agreements between MainePERS and the investment managers.

The 123rd Legislature created an Investment Trust in FY 2008 with a \$100 million initial contribution for the purpose of investing funds set aside by the State of Maine to cover Other Post-Employment Benefits (OPEB) liabilities for State retiree health insurance benefits. MainePERS Trustees were named Trustees for this Investment Trust and have the responsibility for investing these funds. As of June 30, 2018, the market value for the OPEB assets was \$256.9 million, an increase of \$27.3 million over the prior year end. The State of Maine contributed \$4.0 million in August 2017.

PROGRAM FUNDING

Funding Status of the State Employee and Teacher Retirement Program

The actuarial funded status of the State Employee and Teacher Retirement Program, or the ratio of plan assets to plan liabilities, increased in FY 2018 from 80.9% to 81.4%, primarily due to actuarial liability gains. Ten years ago, the funding ratio was 74.0%. Please see the MainePERS Comprehensive Annual Financial Report for an understanding of the difference between market and actuarial values.

The unfunded actuarial liability (UAL) of the State Employee and Teacher Retirement Program increased in FY 2018 from \$2.581 billion at June 30, 2017 to \$2.611 billion at June 30, 2018, offsetting some of the liability gains. While investment returns on a market value basis were 10.3%, the return on an actuarial value of asset basis was 7.86% for FY 2018 because one-third of FY 2016 losses resulting from a return of 0.6% are still being smoothed in to the actuarial return. The FY 2018 actuarial return is higher than the actuarial investment return assumption of 6.75%. (See the Investments section for market returns.)

Funding Status of the Legislative Retirement Program

The Legislative Program was funded at 146.3% as of June 30, 2018, primarily because few legislators qualify for a retirement benefit under the terms of the program even though contributions were made on their behalf at one point in time. No employer contribution is currently required because of the overfunded status of the program.

Funding Status of the Judicial Retirement Program

The actuarial funded ratio of the Judicial Retirement Program has in recent years remained close to 100%. As of June 30, 2018, the actuarial funded ratio was 102.4%.

Funding Status of the Participating Local District Consolidated Retirement Plan

The Participating Local District Consolidated Retirement Plan (PLD Plan) consisted of 306 participating local districts at December 31, 2018. The actuarial funded ratio of the Plan increased from 86.5% at June 30, 2017 to 89.5% at June 30, 2018. The

Participating Local District Advisory Committee continuously monitors the PLD Plan to ensure that it maintains a strong fiscal condition.

MainePERS and the Participating Local District Advisory Committee recently completed a set of proposed changes to the PLD Plan. These changes are designed to manage market risk, strengthen the future funding of the PLD Plan, and strengthen MainePERS ability to pay benefits throughout each retiree's life. These changes were enacted by PL 2017, c. 392 and through rulemaking, with most of the changes effective July 1, 2019. These changes received national recognition for their contribution to Plan sustainability in 2018.

OPERATIONS

New Office Location

MainePERS supported construction of a build-to-suit office building at 139 Capitol Street in Augusta. The System occupied the new building on January 14, 2019. Although the completion and move-in date did not occur until 2019, construction support required a significant amount of staff time in FY 2018.

Changes in Board Membership

Board Chair Brian Noyes was reappointed and confirmed by the Senate on January 23, 2018. Long-standing Board Vice Chair Ben Viola ended his tenure as a trustee in August of 2018. A replacement has not yet been confirmed. Trustee Richard Metivier was elected Vice Chair of the Board in September of 2018. State Treasurer Henry Beck became a Trustee in January of 2019 upon taking office.

Legislative

Resolve Chapter 57, as enacted by the Second Regular Session of the 128th Legislature, authorized the continuation of the working group established to evaluate and design retirement plan options for state employees and teachers. A report of the working group is due no later than December 1, 2019.

Public Law Chapter 378, as enacted by the Second Regular Session of the 128th Legislature, authorized MainePERS to offer long-term disability insurance coverage. The enacted law required MainePERS to report on the use of that authority by January 31, 2019 and a report was submitted to the Committee on January 30, 2019.

Qualified Plan Status

In 2014, MainePERS received updated favorable "determination letters" from the Internal Revenue Service stating that all the plans administered by MainePERS continue to qualify for favorable tax treatment under the provisions of the Internal

Revenue Code. The IRS subsequently eliminated the cyclical determination letter program and will now issue determination letters only for new or terminating plans and in certain other limited circumstances. MainePERS continues to closely monitor tax law changes to ensure that the pension plans continue to comply with federal law and maintain their qualified status. MainePERS is developing an operational compliance program to identify and correct any non-compliance with plan documents.

Audit

The independent audit of the MainePERS financial statements for the year ended June 30, 2018 resulted in an unqualified opinion. An unqualified opinion means that, in the opinion of the auditor, the financial statements present fairly, in all material respects, the fiduciary net position of the System as of June 30, 2018, in conformity with generally accepted accounting principles.

Awards and Certifications

Government Finance Officers Association Certification - In 2018, the System submitted its FY 2017 Comprehensive Annual Financial Report (CAFR) to the Government Finance Officers Association (GFOA) Certificate of Achievement for Excellence in Financial Reporting Program and was awarded the Certificate of Excellence for the fourteenth consecutive year. In order to be awarded this certificate, a governmental unit must publish an easily readable and efficiently organized CAFR, with contents that meet or exceed rigorous program standards and satisfy both generally accepted accounting principles and applicable legal requirements. A Certificate of Achievement is valid only for one year, and the System's FY 2018 CAFR has been submitted to the GFOA.

Public Pensions Standards Award - In 2018, for the eleventh consecutive year, the System was awarded the Public Pension Coordinating Council's Recognition Award for Funding. To receive this award, retirement programs must meet professional standards for plan funding as set forth in the Public Pension Standards. The regular flow of required contributions and the up-front funding of new liabilities were listed as factors contributing to the System's receipt of this award.

Member and Retirement Services

MainePERS was serving approximately 98,000 active members and retirees as of December 31, 2018. The System approved benefits for 1,930 new retirees during CY 2018. This represents an increase of 14% from CY 2017, with 46% of the CY 2018 retirees being teachers. State employee retirements increased by 28% over CY 2017, and participating local district retirements increased by 20%.

Required specific statistical information about members and retirees can be found in Attachment 1.

Group Life Insurance

At the end of CY 2018, approximately 51,000 state, teacher and participating local district employees and retirees had Group Life Insurance coverage under the plan administered by MainePERS. Employers remit premium payments to MainePERS for these participants. MainePERS approved 633 life insurance claims with a value of approximately \$12 million in CY 2018.

Employer Services

MainePERS relies on participating employers to electronically report earnings, contributions, and work history at least once a month in order to maintain the up-to-date information needed to determine a member's eligibility for retirement and the amount the member will receive in benefits. For CY 2018, MainePERS received and processed a wide variety of employer-provided records regarding more than 57,000 public employees who work at one or more of the 600 employers served.

MainePERS works closely with employers to support accurate and timely reporting of employment information and contributions. System staff provides employers with training, consultation and written materials to assist in their reporting. The System provided 20 in-person employer training sessions during CY 2018.

MainePERS continues to solicit feedback and guidance from an Employer Reporting Work Group comprised of teacher and participating local district employers. Regular meetings with the State of Maine's Office of the State Controller help to assure balanced consideration of reporting needs and improved system capability. The System's website includes a section specifically for employers. The *Employer Update*, an electronic update focused on employer specific matters, was published four times during CY 2018.

Document Center

The Document Center is the entry point for support of a paperless work environment. This year the staff planned for managing document induction post-move in a new environment with less square footage. The transition to new space went well with business support continuing shortly after the relocation efforts.

Cost-of-Living Adjustment (COLA)

The Board of Trustees is directed by statute to annually adjust the retirement benefits of its eligible retirees by a cost-of-living adjustment (COLA) equal to the change in the Consumer Price Index for All Urban Consumers (CPI-U) over the 12

months preceding June 30 of each year, subject to certain limitations. The CPI-U at June 30, 2018 was 2.9%. Eligible retirees from the State Employee and Teacher, Legislative and Judicial retirement programs were granted a regular cost-of-living adjustment of 2.9% on the first \$21,818.30 of benefit. Eligible retirees from the Participating Local District Consolidated Retirement Program were granted a regular cost-of-living adjustment of 2.5%, the maximum annual increase permitted under that Plan.

Disability Services

MainePERS staff continues to work with stakeholders on improving its service to those seeking disability retirement benefits and filing administrative appeals. This work includes:

- Disability Retirement Task Force - A MainePERS constituted task force has been regularly meeting since late 2014 to oversee a comprehensive review of the MainePERS disability retirement program. In 2018 that input related to development of a Long Term Disability Insurance Program.
- Long Term Disability Insurance (L.T.D.I.) - MainePERS is working with a consulting firm that has expertise in scoping, forming and drafting requests for proposals ("RFP") in the disability insurance market. The expectation is that a RFP will be issued for an L.T.D.I. insurance carrier this spring, award the contract in the first half of FY 2020, and have the program operational and available to public employers soon thereafter.

Required specific statistical information about the disability program can be found in Attachment 2.

Information Technology

MainePERS technology continues to evolve as business needs and security demands dictate. Activities this year include:

- Relocation of Off-Site Data Center - The System's off-site data center, which houses backup IT infrastructure, was relocated from a facility in Portland to a more suitable facility in Brunswick. Along with this move, we migrated our backup printing capacity to the same secure facility. Several monthly payroll processing batches have been successfully produced at the new location.
- New Office Building/New Data Center - With the relocation of the System's main office to a new building, a new computing network and data center were constructed. Moving to the new facility included installing new computing, network and storage hardware, and relocating some existing equipment.

- New technology partner for Managed IT Services – In 2018, a RFP was issued for Managed IT Services, resulting in the selection of a new vendor. This new vendor managed the migration project and assumed the role of managing the System’s network infrastructure in coordination with the building move.
- The Information Technology Oversight Council continues to guide the overall operations of the Information Technology Department and the development of MainePERS’ Cybersecurity Program. The Cybersecurity Program is based upon the National Institute of Standards and Technology (NIST). The Council provides oversight and planning responsibilities while fulfilling the roles of virtual Chief Information Officer and Chief Information Security Officer.
- Periodic business continuity plan testing was conducted in 2018. A primary emphasis was on MainePERS’ ability to generate a retiree benefits payroll from a disaster recovery site. The test was successful.
- The commitment to security awareness continued in 2018 with MainePERS conducting security awareness training for all staff. This year’s training included security experts and a representatives from the Federal Bureau of Investigation’s cybercrimes program.
- MainePERS acquired two new technology partners related to System Information and Event Management (SIEM) software providing greater visibility of the computing environment.

DEFINED CONTRIBUTION PLANS

MaineSTART

The System continues to promote its pre-tax defined contribution/deferred compensation retirement plans established under sections 401(a), 403(b) and 457(b) of the Internal Revenue Code, collectively referred to as MaineSTART, to its participating local district employers. MaineSTART offers a group of Vanguard funds designed to be low cost and easy to understand. At the close of 2018, the total number of PLD employers that offer employees access to MaineStart was 67, with a total of 1,113 participants.

BUDGET

The System’s administrative costs and expenses are directly charged against the assets of the applicable program. The System’s budgeted operating expenses are approved by the Board of Trustees prior to the start of each fiscal year and reported to this Committee.

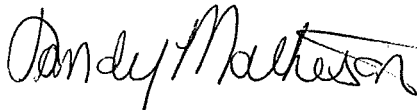
The FY 2019 Board-approved administration budget is \$15,231,656. MainePERS continuously reviews costs to identify efficiency improvements.

Required specific information about the budget and administrative expenses can be found in Attachments 3 and 4. Required specific information about employee and employer contributions can be found in Attachment 5.

CONCLUSION

Please accept this report on behalf of the Maine Public Employees Retirement System. We welcome questions and are happy to address them as the Committee requests and in the format desired.

Respectfully submitted,



Sandra J. Matheson
Executive Director

SJM/mg

Attachments

cc: Members, Board of Trustees
Grant T. Pennoyer, Executive Director, Legislative Council
Rachel Tremblay, Office of Fiscal and Program Review
Henry Fouts, Esq., Office of Policy and Legal Analysis

NEW RETIREES	
Calendar Year 2018	
5 M.R.S.A. § 17103(F)	
Plan Status	Retired Members
State	588
Teacher	880
Legislative	2
Judicial	5
Participating Local District	455
Total	1,930

NEW ACTIVE MEMBERS	
Calendar Year 2018	
5 M.R.S.A. § 17103(G)	
Plan Status	New Active Members
State	1,146
Teacher	1,812
Legislative	28
Judicial	2
Participating Local District	1,441
Total	4,429

DISABILITY RETIREMENT and APPEALS		
Calendar Year 2018		
5 M.R.S.A. § 17103(J)(1)-(4)		
	Count	Percentage
NEW APPLICATIONS		
Disability applications processed and acted upon in 2017¹	92	
Applicants awarded disability retirement at the applications stage	56	61%
Applications terminated due to death	0	
Applicants denied at the application stage²	35	39%
DISABILITY APPEALS³		
Number of appeals pending 12/31/2017	42	
Number of appeals filed in 2018	20	
Total active appeals closed in 2018	25	
Appeals Withdrawn or Abandoned	9	
Appeals Resolved on the Merits	16	
<i>Total resulting in denial of benefits</i>	13	
<i>Total resulting in the award of benefits⁴</i>	3	19%
Number of Appeals Pending 12/31/18	37	

¹ Seventeen (17) applications were withdrawn by members prior to a decision being issued

² 5 M.R.S. §17103 (11) (1) (2) and (3) require the System to report on processes that are no longer in effect. In lieu of the information originally required, an accounting of the disposition of cases in the application phase is provided.

³ This section addresses appeals of application denials. Appeals may not be filed and often are not completed in the same calendar year as the application denial.

⁴ This consists of two (2) cases where the Executive Director granted benefits upon reconsideration after receiving additional information during the appeals process and one case where the Board of Trustees reversed the denial based on a recommendation from an independent hearing officer. Nineteen percent of cases resolved on the merits during an appeal resulted in the award of benefits. Of appeals closed in 2018, which includes withdrawn and abandoned appeals, 12% resulted in benefits.

**BUDGET STATUS OF ADMINISTRATIVE OPERATIONS AND
FUNCTIONS
FY 2018-2019**

5 M.R.S.A. § 17103(E)

	FY 2019 Budget	07/01/2018- 12/31/2018 Actual	01/01/2019- 06/30/2019 Expected	Projected Surplus /(Deficit) ¹
Personal Services	7,511,400	3,298,150	3,934,517	278,733
Professional Services²	1,257,360	554,953	780,910	(78,503)
Communications	505,674	230,782	292,118	(17,226)
Building Operations	581,627	170,883	427,400	(16,656)
Computer Maintenance and Supplies	3,021,047	1,222,320	1,571,777	226,950
Depreciation	1,614,288	743,554	870,735	(1)
Professional Development	150,995	34,592	116,467	(64)
Medical Records and Exams	211,000	133,225	79,275	(1,500)
Miscellaneous Operating Expenses	378,265	159,435	245,768	(26,938)
Total Administrative Expenses	15,231,656	6,547,894	8,318,967	364,795

¹The Projected Surplus at December 31, 2018 is attributable in part to vacant positions occurring during the fiscal year and a projected surplus in computer maintenance and supplies. Any realized savings at the close of the fiscal year will inure to the trust funds.

²Professional Services include actuarial and legal service fees, as well as hearing officers' services related to appeals.

SUMMARY OF ADMINISTRATIVE EXPENSES	
FY 2018	
5 M.R.S.A. § 17103(D)	
Personal Services	7,886,063
Professional Services	2,037,301
Communications	174,784
Office Rent	274,534
Computer Maintenance and Supplies	950,917
Depreciation	1,549,133
Professional Development	87,530
Medical Records and Exams	28,230
Miscellaneous Operating Expenses¹	1,035,121
Total Administrative Expenses²	13,963,613

¹Includes loss on sale of 96 Sewall Street property

²Total Administrative Expenses include all expenses of the System. Refer to the CAFR for a breakdown of administrative expenses across plans.

EMPLOYER CONTRIBUTIONS IN 2018
5 M.R.S.A. § 17103(I)

Plan Status	Employee Contributions	Employer Contributions	Total Payments to Retirees
State ¹	46,350,299	156,769,614	300,719,857
Teacher	94,494,581	183,903,265	509,661,913
Judicial	603,875	1,179,328	3,804,709
Legislative	153,881	-	459,746
Participating Local Districts	48,118,811	56,687,392	154,876,309
Total	189,721,447	398,539,599	969,522,534

¹State Plan totals include Governors